



United States Government Accountability Office

Report to the Honorable Jackie Speier,
House of Representatives

January 2021

DEPARTMENT OF DEFENSE

Actions Needed to Improve Accounting of Intradepartmental Transactions

Accessible Version



GAO Highlights

Highlights of [GAO-21-84](#), a report to the Honorable Jackie Speier, House of Representatives

Why GAO Did This Study

Since 1995, GAO has designated DOD financial management as high risk because of pervasive weaknesses in its financial management systems, controls, and reporting. DOD's long-standing intradepartmental eliminations material weakness reflects DOD's inability to adequately record and reconcile its intradepartmental transactions, and has affected DOD's ability to prepare auditable financial statements.

GAO was asked to evaluate DOD's process for performing intradepartmental eliminations. This report examines the extent to which DOD has (1) identified and taken steps to address issues related to intradepartmental eliminations and (2) established and implemented policies and procedures related to intradepartmental eliminations.

GAO interviewed DOD officials about intradepartmental eliminations processes and reviewed DOD policies and procedures to identify the extent to which procedures have been implemented to record and reconcile intradepartmental transactions.

What GAO Recommends

GAO is making five recommendations to DOD, including that DOD should (1) take actions to ensure that its components follow its policy for using G-Invoicing's GT&C functionality and (2) develop short-term solutions that address causes for trading partner differences before G-Invoicing is fully implemented. DOD agreed with all five recommendations and cited actions to address them.

View [GAO-21-84](#). For more information, contact Kristen Kocielek at (202) 512-2989 or kocielek@gao.gov.

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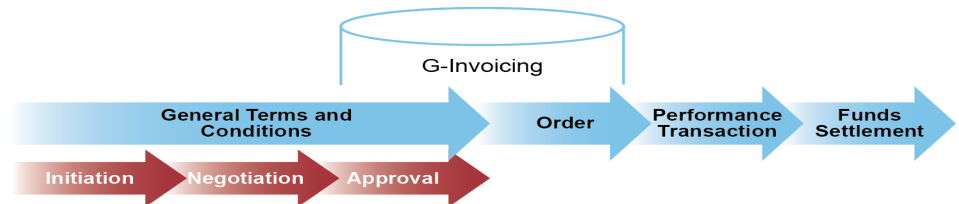
What GAO Found

The Department of Defense (DOD) has a long-standing material weakness related to intradepartmental transactions. Intradepartmental transactions occur when trading partners within the same department engage in business activities—such as the Department of the Army as a seller and the Department of the Navy as a buyer within DOD. As part of the standard process of preparing department-wide financial statements, intradepartmental transaction amounts are eliminated to avoid overstating accounts for DOD. For the fourth quarter of fiscal year 2019, DOD eliminated approximately \$451 billion of net intradepartmental activity. Auditors continue to report a material weakness related to DOD's processes for recording and reconciling intradepartmental transaction amounts that are necessary to eliminate the transactions and prepare reliable consolidated financial statements.

DOD has identified implementation of the Government Invoicing (G-Invoicing) system as its long-term solution to account for and support its intradepartmental activities. In fiscal year 2020, DOD issued a policy requiring all DOD components to use G-Invoicing's General Terms and Conditions (GT&C) functionality for initiating and approving GT&C agreements—a necessary step for using subsequent G-Invoicing functionalities (see figure). GAO found the use of this functionality varied among selected DOD components because of issues such as inconsistency in DOD policies and numerous changes to G-Invoicing system specifications. If DOD components do not implement the GT&C functionality, there is an increased risk of delay in full implementation of G-Invoicing to help remediate the intradepartmental eliminations material weakness.

General Terms and Conditions Agreement Process in Government Invoicing

Agreements must be initiated and approved in the General Terms and Conditions functionality before trading partners can conduct buy/sell activity in Government Invoicing's (G-Invoicing) subsequent functionalities.



Source: GAO analysis based on Department of Defense information. | GAO-21-84

Text of General Terms and Conditions Agreement Process in Government Invoicing

The first module to be implemented by the Department of Defense, General Terms and Conditions (GT&C), is the first stage of the buy/sell transaction life cycle. Agreements must be initiated and approved in GT&C before trading partners can conduct buy/sell activity in government invoicing's (G-Invoicing) subsequent functionalities.

Stages

- 1) General Terms and Conditions
 - a) Initiation
 - b) Negotiation
 - c) Approval
- 2) Order
- 3) Performance Transaction
- 4) Funds Settlement

Source: GAO analysis based on Department of Defense information. | GAO-21-84

Although DOD has identified G-Invoicing as its long-term solution, GAO found that DOD has not implemented an overall department-wide strategy to address its intradepartmental eliminations material weakness in the short term. Further, GAO found that while DOD issued a department-wide policy in May 2019 with new requirements for reconciling intradepartmental transactions, the Defense Finance and Accounting Service and selected DOD components have not updated their policies or implemented several of the new requirements. Without a short-term strategy that includes identifying the causes of issues and consistently implementing department-wide policies across DOD, DOD's efforts to resolve differences in intradepartmental transaction amounts—including its efforts in the long term—will likely be inefficient and ineffective.

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Abbreviations

Air Force	Department of the Air Force
Army	Department of the Army
DDRS	Defense Departmental Reporting System
DDRS-AFS	Defense Departmental Reporting System—Audited Financial Statements
DDRS-B	Defense Departmental Reporting System—Budgetary
DFAS	Defense Finance and Accounting Service
DISA	Defense Information Systems Agency
DOD	Department of Defense
ERP	enterprise resource planning
FMR	<i>Financial Management Regulation</i>
G-Invoicing	Government Invoicing
GT&C	General Terms and Conditions
Navy	Department of the Navy
OIG	Office of Inspector General
OMB	Office of Management and Budget
OUSD	Office of the Under Secretary of Defense
SOP	standard operating procedure
Treasury	Department of the Treasury
TFM	<i>Treasury Financial Manual</i>

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January 14, 2021

The Honorable Jackie Speier
House of Representatives

Dear Ms. Speier:

The Department of Defense (DOD) is responsible for about half of the federal government's discretionary spending, yet it remains the only major federal agency that has been unable to receive an audit opinion of any kind on its department-wide financial statements.¹ Since 1995, GAO has designated DOD financial management as high risk because of pervasive weaknesses in its financial management systems, business processes, internal controls, and financial reporting.² These weaknesses have adversely affected DOD's ability to prepare auditable financial statements, which is one of three major impediments preventing us from expressing an opinion on the U.S. government's consolidated financial statements.³

The National Defense Authorization Act for Fiscal Year 2014 required the Secretary of Defense to ensure that a full audit was performed on DOD's fiscal year 2018 financial statements and to submit the results to Congress no later than March 31, 2019.⁴ DOD underwent a full audit in

¹Discretionary spending refers to outlays from budget authority that are provided in and controlled by appropriation acts, unlike mandatory spending, such as Medicare and other entitlement programs. For fiscal year 2019, DOD's discretionary budget authority of \$698 billion constituted about 51 percent of the total discretionary budget authority of the federal government.

²GAO, *High-Risk Series: Substantial Efforts Needed to Achieve Greater Progress on High-Risk Areas*, [GAO-19-157SP](#) (Washington, D.C.: Mar. 6, 2019).

³The other two impediments preventing us from rendering an opinion on the federal government's consolidated financial statements are (1) the federal government's inability to account for intragovernmental activity and balances between federal entities adequately and (2) the weaknesses in the federal government's process for preparing the consolidated financial statements. See GAO, *Financial Audit: FY 2019 and FY 2018 Consolidated Financial Statements of the U.S. Government*, [GAO-20-315R](#) (Washington, D.C.: Feb. 27, 2020).

⁴Pub. L. No. 113-66, div. A, § 1003, 127 Stat. 672, 842 (Dec. 26, 2013). This provision was repealed by the National Defense Authorization Act for Fiscal Year 2018, Pub. L. No. 115-91, div. A, § 1002(b), 131 Stat. 1283, 1538 (Dec. 12, 2017), which instead enacted a permanent requirement for annual DOD financial statement audits, now codified as section 240a of Title 10, *United States Code*.

fiscal years 2018 and 2019 and received a disclaimer of opinion for both years.⁵ In fiscal year 2019, auditors reported 25 material weaknesses in internal control related to DOD's financial reporting processes.⁶

One of the material weaknesses auditors identified related to eliminations of intradepartmental transactions.⁷ Intradepartmental transactions are transactions such as the buying and selling of items (buy/sell) between two entities (e.g., the Department of the Army and the Department of the Navy) within the same organization (DOD). When financial statements are prepared at the DOD consolidated level, intradepartmental transactions and balances should be in agreement; these amounts are then eliminated from the financial statements. If two entities within DOD (known as components) engaged in intradepartmental activity but did not both record the same intradepartmental transaction amounts, the transactions would not be in agreement in the components' financial statements. If not properly resolved, this lack of agreement would result in errors in DOD's consolidated financial statements. Properly eliminating intradepartmental transactions results in the presentation of all account balances in the consolidated financial statements as if DOD and its components were a single organization. For the fourth quarter of fiscal year 2019, DOD eliminated approximately \$451 billion of net intradepartmental activity.

DOD's long-standing intradepartmental eliminations material weakness reflects DOD's inability to record and reconcile its intradepartmental transactions adequately. According to DOD auditors, the primary cause for this material weakness is system limitations—that is, components'

⁵A disclaimer of opinion arises when the auditor is unable to obtain sufficient, appropriate audit evidence to provide a basis for an audit opinion; the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive and accordingly does not express an opinion on the financial statements.

⁶A material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis. A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis.

⁷The DOD Inspector General again identified intradepartmental eliminations as a material weakness in DOD's fiscal year 2020 financial reports, which DOD issued after we completed the majority of our work for this review.

accounting systems are not configured to capture intradepartmental data necessary for transaction-level identification and reconciliation to facilitate required eliminations.⁸ Until DOD takes steps to address this material weakness, DOD management and Congress will not be able to rely on financial information in the agency's core financial reporting system and, as a result, may not have reliable and accurate financial information to support their decision-making.⁹

You requested that we evaluate DOD's process for intradepartmental eliminations. This report examines the extent to which (1) DOD and selected components have identified issues related to intradepartmental eliminations and taken steps to resolve them and (2) DOD has established and implemented policies and procedures related to intradepartmental eliminations.

For our two objectives, we analyzed DOD's intradepartmental eliminations summary data by type, quantity, and dollar amount for the second quarter of fiscal year 2020. For both objectives, we focused on

- buy/sell intradepartmental transactions, as they represented approximately 92 percent of the total volume of all DOD's intradepartmental eliminations for the selected period;¹⁰

⁸A reconciliation consists of comparing two or more sets of records (in this case, amounts between two DOD components), researching and resolving any differences, and recording adjustments if necessary.

⁹DOD uses the Defense Departmental Reporting System (DDRS) for financial reporting purposes. DDRS has several modules, two of which are DDRS-Budgetary (DDRS-B) and DDRS-Audited Financial Statements (DDRS-AFS). DDRS-B accepts summary-level information from field-level accounting systems (accounting systems that DOD components use) and ensures that they follow the standard format for government reporting. The Defense Finance and Accounting Service uses DDRS-AFS in preparing the consolidated financial statements.

¹⁰The *Treasury Financial Manual* identifies five categories of intragovernmental transactions—buy/sell transactions, fiduciary transactions, transfers transactions, custodial and non-entity transactions, and general fund transactions.

-
- five Tier 1 DOD components, except for the Military Retirement Fund, which did not have any buy/sell intradepartmental transactions for the selected period;¹¹ and
 - three Tier 2 DOD components, which had the largest buy/sell elimination dollar amounts for the selected period—the Defense Logistics Agency, the Defense Information Systems Agency (DISA), and the U.S. Transportation Command.¹²

The eight Tier 1 and Tier 2 components selected for our review represent 91 percent of the total dollars of DOD intradepartmental buy/sell eliminations for the selected period.

To address our first objective, we reviewed (1) prior reports issued by GAO, DOD's Office of Inspector General (OIG), and DOD auditors for fiscal years 2015 through 2019 and (2) auditors' notices of finding and recommendation with DOD's corresponding corrective actions for fiscal year 2019 to gain an understanding of issues related to intradepartmental eliminations that auditors identified. Additionally, we conducted interviews with the Office of the Under Secretary of Defense (OUSD) (Comptroller), Defense Finance and Accounting Service (DFAS), and selected DOD component officials to evaluate (1) procedures implemented to identify the issues associated with intradepartmental eliminations, (2) steps taken and initiatives planned to resolve identified issues, and (3) monitoring activities implemented to determine if the actions taken to resolve the identified issues are effective.

To address our second objective, we reviewed applicable government-wide, DOD, and DFAS guidance to determine the extent to which DOD had established guidance for recording and reconciling intradepartmental transactions. We also interviewed DOD officials to determine if DFAS and

¹¹Tier 1 components are components that are required by the Office of Management and Budget to prepare audited financial statements. For fiscal year 2019, DOD identified eight Tier 1 components and one fund—Department of the Army (Working Capital and General Fund), Department of the Air Force (Working Capital and General Fund), Department of the Navy (Working Capital and General Fund), U.S. Marine Corps (General Fund), U.S. Army Corps of Engineers, and the Military Retirement Fund. For this report, we defined components as including the related funds (e.g., Department of the Army as one component consisting of a working capital fund and a general fund). Therefore, for the purpose of this report, we reviewed five Tier 1 components—Department of the Army, Department of the Navy, Department of the Air Force, U.S. Marine Corps, and the U.S. Army Corps of Engineers.

¹²Tier 2 components (as identified by DOD) consist of 15 components required by DOD policy to issue annual audited financial reports.

selected DOD components have implemented the requirements in DOD's department-wide guidance for recording and reconciling intradepartmental transactions. Further details on our scope and methodology are provided in appendix I.

We conducted this performance audit from March 2020 to January 2021 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

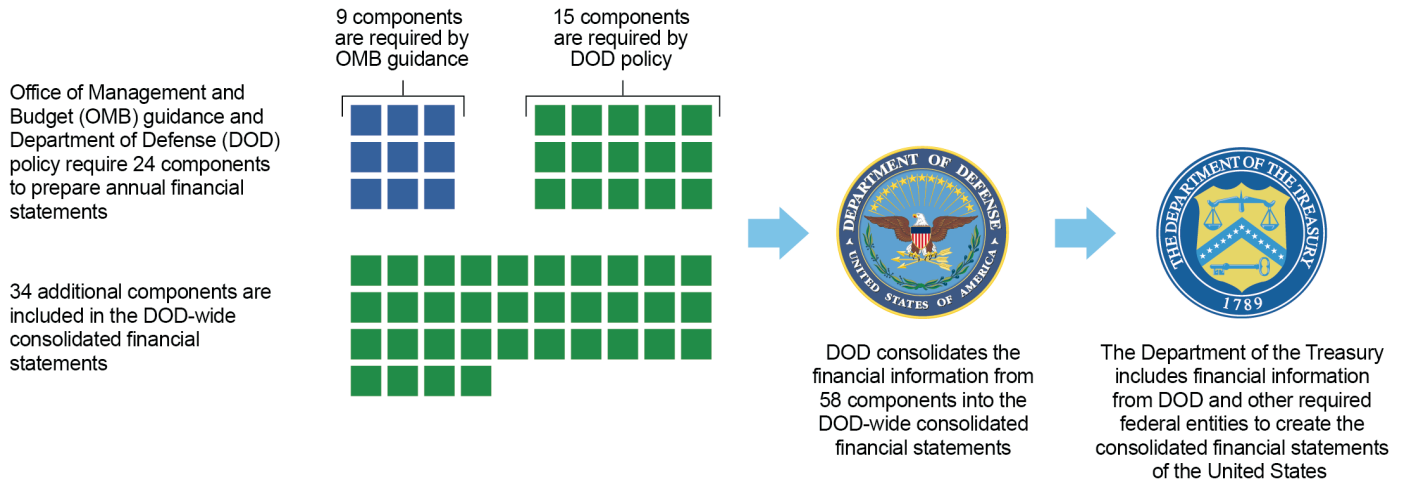
Background

DOD is composed of over 50 individual components, including military departments—the Department of the Army (Army), the Department of the Air Force (Air Force), and the Department of the Navy (Navy)—and other defense agencies, such as DISA. Office of Management and Budget (OMB) guidance requires nine DOD components to prepare annual financial reports, and DOD policy requires an additional 15 components to prepare annual financial reports.¹³ Further, DOD is required by law to prepare audited financial statements annually covering all accounts and associated activities of each of its components, which it prepares by consolidating all DOD financial information from these 24 components as well as 34 other components.¹⁴ (See fig. 1.) The DOD-wide consolidated financial statements present the financial position of DOD as a whole.

¹³Financial statements provide information about an organization's financial position—such as assets (what it owns) and liabilities (what it owes)—as of a certain point in time, in addition to the financial results of its operation—such as revenue (what came in) and expenses (what went out)—over a period of time, such as a fiscal year. Financial statements are prepared based on the summarized, or consolidated, financial information from an organization's accounting systems.

¹⁴31 U.S.C. § 3515(a).

Figure 1: Department of Defense’s Annual Financial Statement Consolidation Process



Source: GAO analysis of Department of Defense information. | GAO-21-84

As figure 1 shows, DOD and other federal agencies submit their financial information to the Department of the Treasury (Treasury), which then combines the information for presentation in the consolidated financial statements of the U.S. government. Reliable and complete financial information is necessary to help agency management and Congress understand agency finances, make informed decisions on policies and resources, and hold agency officials accountable for their use of resources.

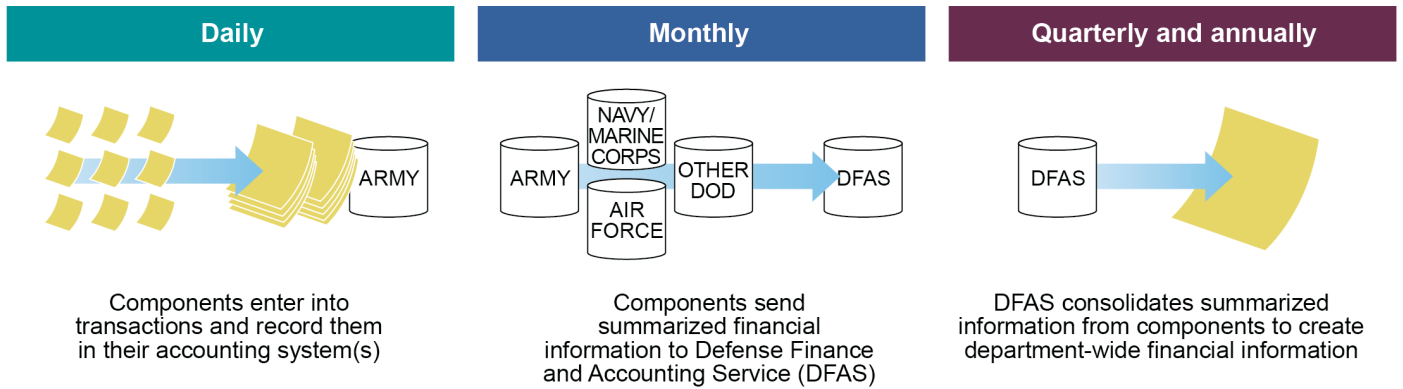
At DOD, components use multiple accounting systems to record and summarize their financial transactions.¹⁵ Each month, quarter, and year, these components provide summarized financial information to DFAS, the DOD agency that provides accounting support for DOD.¹⁶ DFAS uses DOD’s core financial reporting system, the Defense Departmental Reporting System (DDRS), to consolidate the summarized financial information from individual components into DOD’s department-wide

¹⁵Most components have several accounting systems that capture accounting information. For example, the Army uses the General Fund Enterprise Business System among others to record Army transactions.

¹⁶There are three DFAS sites located in Cleveland, Ohio; Columbus, Ohio; and Indianapolis, Indiana. DFAS Cleveland supports the Navy and Marine Corps, and DFAS Columbus supports the Air Force. DFAS Indianapolis provides most of the Army’s accounting support, but DFAS Columbus also provides a small portion.

consolidated financial statements.¹⁷ (See fig. 2.) DDRS standardizes the reporting process across all components.

Figure 2: Recording of DOD Accounting Transactions



Source: GAO analysis of Department of Defense (DOD) information. | GAO-21-84

Text of Figure 2: Recording of DOD Accounting Transactions

5) Daily

- a) Components enter into transactions and record them in their Accounting systems.

6) Monthly

- a) Components send summarized financial information to Defense Finance and Accounting Service (DFAS)

7) Quarterly and Annually

- a) DFAS consolidates summarized information from components to create department-wide financial information

¹⁷The one exception at DOD is the U.S. Army Corps of Engineers, which prepares its own financial statements using core DOD processes and, with DFAS support as needed, submits its financial information for DOD consolidation purposes.

Intradepartmental Transactions at DOD

Intragovernmental transactions are business activities that occur between two government organizations, or trading partners, such as DOD and Treasury.¹⁸ Business activities between trading partners within the same department, such as the Army and Navy within DOD, are called intradepartmental transactions. The *Treasury Financial Manual* (TFM) describes five categories of intragovernmental transactions—buy/sell, fiduciary, transfers, custodial, and general fund.¹⁹ Of these five, DOD uses the following categories for its intradepartmental transactions:

- **Buy/sell.** Transactions that occur between two trading partners where goods or services are purchased by one entity (buyer) from another entity (seller). For example, when DISA provides information system support services to the Navy for a fee, DISA is considered the seller and Navy is considered the buyer.
- **Fiduciary.** Transactions that occur when one entity manages or collects funds for another, including employee benefits, for example, when the Navy contributes funds to the Military Retirement Fund, which DOD administers.²⁰
- **Transfers.** Transactions that occur when an agency needs to transfer budgetary or proprietary resources from one entity or program to another—for example, when a military component re-allocates funds initially allocated for construction to operations and maintenance.²¹

For fiscal year 2019, the buy/sell category represented 87 percent of the volume of intradepartmental transactions at DOD. Fiduciary and transfer

¹⁸Trading partners are federal agencies, departments, or entities participating in transactions with each other.

¹⁹Department of the Treasury, *Treasury Financial Manual*, Vol 1, Part 2, Chapter 4700, *Federal Entity Reporting Requirements for the Financial Report of the United States Government*, Appendix 6 (July 2019). Custodial transactions occur when one entity collects funds on behalf of another entity. General fund transactions occur between a federal entity and the General Fund of the U.S. Government.

²⁰The Military Retirement Fund accumulates funds to finance the liabilities of DOD under military retirement and survivor benefit programs included within DOD's Military Retirement System.

²¹Budgetary resources represent budget approval and execution whereas proprietary resources are assets, liabilities, revenues, and expenses.

categories represented 1 percent and 12 percent of DOD intradepartmental transactions, respectively.

Purpose of Intradepartmental Eliminations at DOD

DOD is responsible for properly accounting for and reporting intradepartmental activity balances in its consolidated financial statements. When preparing these statements, intradepartmental transactions and balances should be in agreement and must be eliminated or removed as part of the standard consolidation process. For example, when a trading partner within DOD (seller) records \$100 in accounts receivable in its accounting system, an offsetting accounts payable transaction of \$100 should be recorded during the same period by the DOD component buyer in its accounting system. At the department-wide consolidated level, these intradepartmental transaction amounts need to be eliminated to avoid overstating accounts. In this example, accounts receivable and accounts payable are an example of reciprocal accounts—meaning these two accounts need to balance, that is, have the same dollar amount.²² When these intradepartmental transactions are recorded accurately and within the same accounting period, DOD will be able to eliminate the transactions correctly.

If the two DOD components engaged in an intradepartmental transaction do not both record the offsetting intradepartmental transaction in the same year and for the same amount, the intradepartmental transaction will not be in agreement. If such a disagreement were not properly resolved, it would result in errors (e.g., differences or unmatched amounts) in the DOD consolidated financial statements. DOD officials provided us with an overview of steps DOD takes to reconcile intradepartmental balance differences. First, DFAS informs trading partners of the differences in their intradepartmental transaction amounts. Next, the trading partners coordinate and research the cause of the differing amounts to determine the correct amount and period of each intradepartmental transaction. When performing the research, the trading partners will typically use the best documentation available, such as an invoice or shipping manifest, to determine the correct amount and accounting period. Once the correct amount and accounting period have

²²Reciprocal accounts are pairings of related accounts that should be used by trading partners to reconcile like intradepartmental transactions and balances. For example, reciprocal accounts include (1) Transfers-In to Transfers-Out, (2) Accounts Receivable to Accounts Payable, (3) Liability for Advances to Advances, and (4) Revenue to Expenses. The TFM identifies 36 total reciprocal categories.

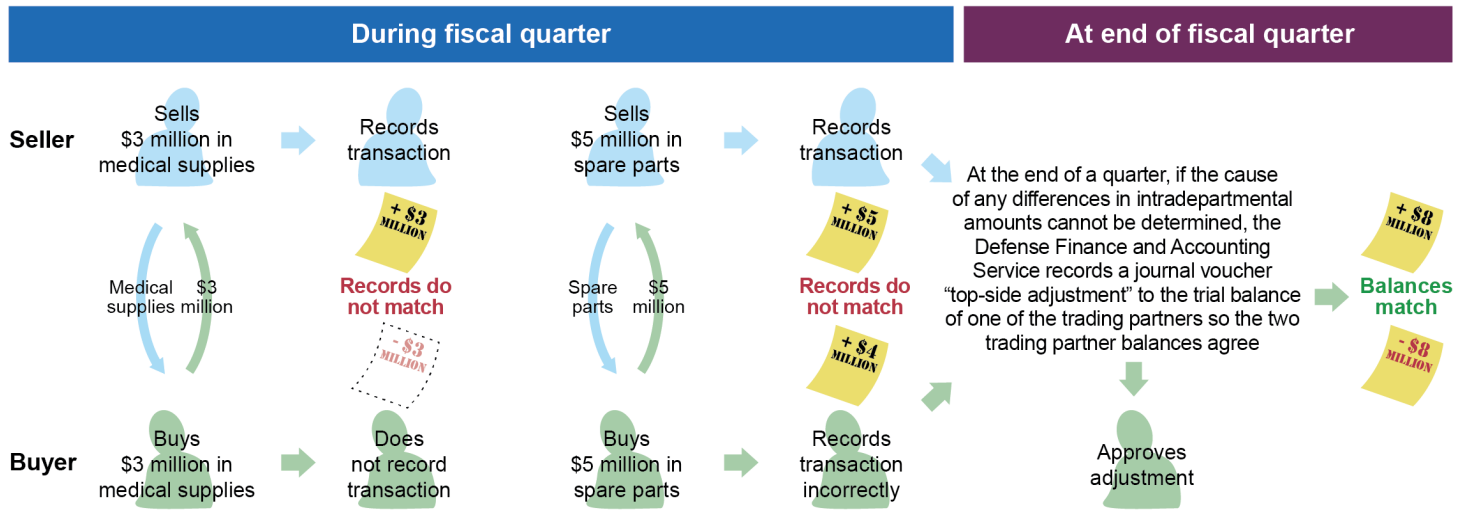
been determined, trading partners will update their accounting systems as necessary to reflect the correct amount.

System controls within DDRS detect intradepartmental imbalances, and financial statements are not considered final until all accounts balance and there are no trading partner differences. At the end of a quarter, if the cause of any trading partner differences in intradepartmental amounts cannot be determined, DFAS records in DDRS a journal voucher adjustment (top-side adjustment)²³ to one of the trading partner's trial balances so the two trading partner balances agree.²⁴ This top-side adjustment in DDRS ensures the balances of one trading partner will be consistent with the balances of the other trading partner. (See fig. 3.) For the fourth quarter of fiscal year 2019, DOD recorded a total of \$112 billion in intragovernmental buy/sell top-side adjustments. Of this amount, DOD considered \$102 billion to be unsupported. DOD auditors have and continue to report DOD's use of top-side adjustments to resolve intradepartmental differences as a control deficiency.

²³According to DOD officials, top-side adjustments are journal voucher adjustments entered in DOD's consolidated financial reporting system to correct accounting records between DOD components. Although DFAS records these top-side adjustments, the adjustments are reviewed and approved by DOD components' management in accordance with memorandums of understanding between the components and DFAS.

²⁴The top-side intragovernmental adjustments include both intradepartmental and non-DOD-related adjustments. DOD officials stated that they do not have the ability to differentiate what portion of the top-side adjustments is intradepartmental versus a trading partner external to DOD (e.g., General Services Administration).

Figure 3: Department of Defense’s Journal Voucher (Top-Side) Adjustment Recording Process



Source: GAO analysis based on Department of Defense information. | GAO-21-84

DOD Has a Long-Term Solution to Address Its Intradepartmental Eliminations Material Weakness but Faces Limitations with Its Implementation

DOD and its components have a long-standing material weakness related to intradepartmental eliminations. To address this material weakness, DOD has begun implementing Treasury’s Government Invoicing (G-Invoicing) system as its long-term solution. This system has potential benefits, such as providing a common platform for recording and processing intradepartmental transactions. However, successful implementation of G-Invoicing may be limited by system design attributes that do not meet DOD’s business needs and inconsistent implementation of G-Invoicing’s General Terms and Conditions (GT&C) functionality by DOD components.

The Majority of DOD Reporting Components Have Auditor-Identified Deficiencies Related to Intradepartmental Eliminations

Of the DOD components required to issue annual financial reports in fiscal year 2019, the majority had auditor-identified deficiencies related to intradepartmental eliminations. OMB guidance requires nine DOD components to issue annual financial reports, and DOD policy requires an additional 15 DOD components to issue annual financial reports.²⁵ Our review of the 23 fiscal year 2019 publicly issued annual financial reports identified that 16 of the reports (approximately 70 percent) included at least one auditor-identified deficiency related to intradepartmental eliminations. Within these 16 reports, auditors cited 15 material weaknesses and two instances of noncompliance with the Federal Financial Management Improvement Act of 1996 related to intradepartmental eliminations.²⁶ Some of the issues that the auditors cited follow:

- Components did not perform periodic, transaction-level reconciliation with trading partners. For example, some components did not periodically compare their accounting records with those of trading partners to identify intradepartmental differences and the reasons why the recorded dollar amounts did not match.
- Some components' accounting systems were unable to capture all necessary trading partner information (e.g., the trading partner identifier code and source document number) at the transaction level to facilitate the required reconciliations and eliminations.
- Components, with the assistance of DFAS, recorded top-side adjustments without transaction-level supporting documentation.

During discussions with DOD officials, we identified similar issues to those cited by the auditors. For example, DOD officials at six of the eight

²⁵Of the 24 components that are required to issue annual financial reports, one component (DOD Component Level Accounts) does not issue its own financial reports. Instead, its financial information is consolidated into the DOD consolidated financial statements. Therefore, we did not include Component Level Accounts in our review.

²⁶The Federal Financial Management Improvement Act of 1996, Pub. L. No. 104-208, div. A §101(f), title VIII, 110 Stat. 3009, 3009-389 (Sept. 30, 1996), requires DOD to establish and maintain financial management systems that comply substantially with the federal financial management systems requirements, applicable federal accounting standards, and the *U.S. Standard General Ledger* at the transaction level.

selected components we reviewed identified accounting system limitations as the primary cause of their intradepartmental eliminations deficiency.

DOD Has Identified G-Invoicing as Its Long-Term Solution

DOD and selected components indicated that implementing G-Invoicing is central to their strategy to account for and support intradepartmental buy/sell activities properly. G-Invoicing is an online platform that Treasury developed to standardize intradepartmental buy/sell activities. As seen in table 1, G-Invoicing consists of four functionalities (modules) that represent the end-to-end processes in four core stages—GT&C, Order, Performance, and Funds Settlement—of the buy/sell transaction life cycle. Though all four modules are available for use, GT&C is the first module to be implemented by DOD. The remaining three modules will be implemented in the future, as components’ accounting systems are configured to interface with G-Invoicing.

Table 1: Four Stages of the Buy/Sell Transaction Life Cycle

Life cycle stage	Government Invoicing module	Module description
1 Origination (initiation), negotiation, and approval of agreement	General Terms and Conditions (GT&C)	Documents the establishment and approval of the interagency agreements (GT&C agreements) that define the terms, conditions, and scope of the activity, and the roles and responsibilities between the trading partners.
2 Submission and acceptance of orders	Order	Documents the agreement between trading partners on goods and services to be traded, which includes prices, quantities, and how the trading partners will fund and account for the items.
3 Notification of delivery and acceptance of goods or services	Performance Transaction	Documents the communication of delivery by the seller and acceptance by the buyer.
4 Remittance of payment	Funds Settlement	Automates the payments for goods and services to trading partners.

Source: GAO analysis based on Department of the Treasury publications. | GAO-21-84

DOD officials stated that they expect the implementation of G-Invoicing to address some of the issues that DOD auditors identified related to DOD’s process for buy/sell activities by providing the following potential benefits:

- **Better communication between trading partners.** G-Invoicing should allow trading partners to share a common platform and a clear record of their negotiations and transactions. The common platform, through an online portal, allows trading partners to initiate, exchange, and approve buy/sell activity and integrate the resulting data from these activities into their accounting systems.

- **Increased transparency.** G-Invoicing should provide a single repository of buy/sell transaction-level activity to ensure the accuracy of transactions for both buyers and sellers. If trading partners' intradepartmental balances differ at the end of the reporting period, both trading partners can access this single repository to reconcile and resolve the differences.
- **Common language and documentation.** G-Invoicing should standardize the terms and forms used when recording buy/sell transactions. For example, G-Invoicing will allow trading partners to capture information such as federal identification codes and lines of accounting that trading partners rely on for the correct accounting of buy/sell transactions.

However, despite potential benefits of implementing the G-Invoicing system, DOD officials identified several limitations with the G-Invoicing system design that do not currently meet DOD's business needs. These limitations include the following:

- **Trading partner identifier lacks detailed information.** G-Invoicing uses a data element referred to as Group Name to identify trading partners. Officials stated that this data element does not meet DOD's business needs because it does not align accountable officers with their roles and responsibilities. If this data element is used as the authoritative trading partner identifier, DOD anticipates continued difficulty in reconciling intradepartmental differences. DOD has recommended that Treasury adopt the Activity Address Code as the authoritative trading partner identifier in G-Invoicing.²⁷
- **System functionality to record approvals is limited.** G-Invoicing's current workflow only permits two levels of approval for trading partner actions, such as initiating or receiving an order. However, DOD's component acquisition rules sometimes require more than two levels of approval before final approval can be provided. Without the ability to use customized approval workflows, DOD components must capture these approvals outside of the G-Invoicing system. DOD has recommended that Treasury enhance its current workflow options to allow more than two levels of approval.
- **Partial order acceptance by supplier is not supported.** G-Invoicing does not allow for the partial acceptance of an order, which is a common need within DOD. For example, if a buyer orders 10 widgets,

²⁷The Activity Address Code is a six-position code that uniquely identifies the specific entity's offices, activities, or organizations.

a particular DOD supplier may only be able to deliver eight widgets. DOD's process allows the supplier to accept a partial order for eight widgets and the buyer to find another supplier for the other two widgets. The G-Invoicing system as currently planned will not allow this. In G-Invoicing, the original order for 10 widgets would have to be canceled and a new order for eight submitted. DOD has recommended that Treasury include partial order acceptance functionality within G-Invoicing.

DOD has communicated these and other concerns as well as its recommendations to Treasury and continues to discuss possible G-Invoicing system enhancements that would meet DOD's business needs. According to DOD officials, because Treasury owns and oversees the G-Invoicing system, DOD does not have control over the system's design and functionality or the time frame in which these identified issues will be resolved.

In the event that Treasury does not implement DOD's recommendations, DOD has proactively begun developing alternative work-arounds. For example, according to DOD officials, Treasury was unable to implement DOD's recommendation that Treasury align G-Invoicing's performance data standards with DOD's internal standards in order to capture and transmit an item's logistical shipping information, such as its serial number, quantity, and size. Lack of logistical data makes it difficult for DOD components to perform full receipt and acceptance of items or reconcile the business activity with specific trading partner data to support accounting transactions. As a result, DOD has begun developing a work-around using DOD's Wide Area Workflow system to capture and attach the necessary performance data standards to processed transactions.²⁸ Until these issues are addressed or alternative work-arounds are implemented, DOD's ability to use G-Invoicing to resolve the intradepartmental eliminations deficiency will be limited.

DOD Components' Implementation of the GT&C Module Is Limited

All eight of the selected DOD components that we reviewed have begun to implement the GT&C module of G-Invoicing, but such implementation

²⁸The Wide Area Workflow is a web-based system for electronic invoicing, receipt, and acceptance. It creates an electronic folder to combine the three documents required to pay a vendor—the contract, invoice, and receiving report.

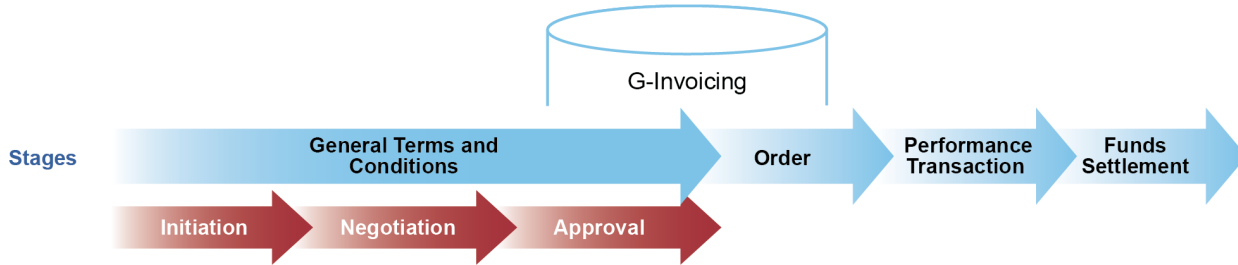
has not been consistent or complete. Although DOD has identified limitations with G-Invoicing, those limitations have not precluded DOD from implementing the GT&C module. DOD issued a December 2019 policy requiring all DOD components to begin using the GT&C module for entering and approving GT&C agreements as of October 2019.²⁹ As shown in figure 4, the GT&C module, representing the first stage of the transaction life cycle, is used by trading partners to initiate, negotiate, and approve GT&C agreements for their buy/sell activities. The GT&C agreements capture the terms, conditions, scope, and roles and responsibilities between trading partners.³⁰ Agreements must be initiated and approved in the GT&C module before trading partners can conduct buy/sell activity in G-Invoicing's other modules. We found that initiation and approvals of the GT&C agreements within the module vary among the selected DOD components. Further, if the GT&C module is not implemented timely by DOD components, there is an increased risk that the overall adoption of G-Invoicing may be delayed.

²⁹Department of Defense, Office of the Under Secretary of Defense, *Implementation Memorandum #1 for G-Invoicing Transition* (Washington, D.C.: Dec. 12, 2019). In May 2019, DOD issued a policy regarding intradepartmental eliminations, effective October 2019, which included a provision for DOD components to begin processing GT&C agreements in G-Invoicing. Though the May 2019 policy included provisions for the implementation of the GT&C module, the December 2019 policy provides more comprehensive guidance for implementing G-Invoicing. The memo references the May 2019 policy, reinforcing the requirement to approve GT&C agreements using G-Invoicing's GT&C module.

³⁰The GT&C agreement is modeled after the Treasury's Bureau of the Fiscal Service General Terms and Conditions (FS Form 7600A), which can be used when one or both trading partners have not implemented the GT&C module.

Figure 4: G-Invoicing’s General Terms and Conditions Agreement Process

The first module to be implemented by the Department of Defense, General Terms and Conditions (GT&C), is the first stage of the buy/sell transaction life cycle. Agreements must be initiated and approved in GT&C before trading partners can conduct buy/sell activity in government invoicing’s (G-Invoicing) subsequent functionalities.



Source: GAO analysis based on Department of Defense information. | GAO-21-84

Text of Figure 4: G-Invoicing’s General Terms and Conditions Agreement Process

The first module to be implemented by the Department of Defense, General Terms and Conditions (GT&C), is the first stage of the buy/sell transaction life cycle. Agreements must be initiated and approved in GT&C before trading partners can conduct buy/sell activity in government invoicing’s (G-Invoicing) subsequent functionalities.

Stages

- 1) General Terms and Conditions
 - a) Initiation
 - b) Negotiation
 - c) Approval
- 2) Order
- 3) Performance Transaction
- 4) Funds Settlement

Source: GAO analysis based on Department of Defense information. | GAO-21-84

Volume of GT&C agreements initiated in the GT&C module varies among DOD components. We found that, as of August 2020, all eight selected components used the GT&C module to initiate GT&C agreements; however, the rate of initiating these agreements varied. For

example, the Navy has taken an aggressive stance in its effort to initiate GT&C agreements within the module and has developed policies and procedures on the use of the GT&C module for its staff to follow. Other selected components have not taken a similarly aggressive approach. DOD officials stated that the Navy views using the GT&C module as an improvement over current processes for initiating agreements because the GT&C module provides visibility over the agreements that trading partners have initiated by placing them into a central repository.

Despite the Navy's aggressive stance in initiating GT&C agreements, other selected components' officials identified various reasons why some trading partners have not consistently entered agreements using the GT&C module. Some officials cited an inconsistency in DOD policies as a reason. For example, DOD's instruction for intradepartmental support agreements references internal DOD forms and does not require the implementation of G-Invoicing when DOD acquires supplies and services.³¹ This inconsistency between DOD's instruction for intradepartmental support agreements and the December 2019 policy has caused confusion between DOD trading partners regarding which policy to follow. In addition, some selected component officials stated that they did not want to commit limited resources to entering agreements using the GT&C module until Treasury finalizes G-Invoicing system specifications. These officials stated that since its release in fiscal year 2018, G-Invoicing has been subject to numerous enhancements that have altered the specifications, which has made it difficult for trading partners to fully adopt the GT&C module.

Limited use of GT&C module by trading partners further prevents completion of the agreement approval process. Officials at five of the eight selected DOD components stated that they were limited in completing approvals of some GT&C agreements—which are necessary before trading partners can conduct buy/sell activity using subsequent G-Invoicing modules—because their trading partners have not fully implemented the use of the GT&C module in order to process and approve agreements. For example, of the 1,000 agreements that the Navy initiated in fiscal year 2020 in the GT&C module, approval has only been completed for about 300 in part because trading partners have not begun using the GT&C module. Going forward, when G-Invoicing has been fully implemented, only these 300 agreements would be available for processing orders in the Order module because both trading partners

³¹Department of Defense, *Support Agreements*, DOD Instruction 4000.19 (Aug. 31, 2018).

have approved these agreements. If either trading partner is not prepared to approve agreements within the GT&C module, the trading partners will need to instead use an offline, paper version of the approval form, which is not as easily accessible to trading partners as approvals entered into the GT&C module.

Selected DOD component officials stated that the need to determine how to re-structure procedures to designate approvers for GT&C agreements has also caused a delay in approving agreements within the GT&C module. Current component acquisition workflow procedures might require multiple, cross-organizational levels of approval for an agreement. However, G-Invoicing only supports two levels of approvals, forcing components to alter their workflows to coincide with G-Invoicing's limitation. This alteration requires components to designate officials to conduct approvals within the system and document any additional levels of approval outside of G-Invoicing. For example, U.S. Transportation Command is in the process of converting from a lengthy coordination of multiple approvals to two approvals for all agreements.

Treasury has identified the completion of GT&C agreements using the GT&C module as necessary to ensure the proper recording and elimination of intragovernmental buy/sell transactions. Although the December 2019 policy required all DOD components to start entering agreements in the GT&C module, in fiscal year 2020 through August, components had only initiated approximately 4,600 agreements and approved approximately 480. This is far fewer than the estimated 34,000 agreements that were initiated and approved by all DOD trading partners outside of the GT&C module in fiscal year 2019. If DOD components do not begin taking steps to enable the entering of agreements into the GT&C module consistently, and if DOD does not update its inconsistent policies requiring the use of the GT&C module, there is an increased risk that the full implementation of G-Invoicing and remediation of the identified deficiency related to intradepartmental eliminations may be further delayed.

DOD Has Developed a Policy to Reconcile Intradepartmental Differences but Lacks an Overall Short-Term Strategy to Address Its

Intradepartmental Eliminations Material Weakness

While DOD has identified G-Invoicing as its long-term solution, it has not implemented an overall department-wide strategy with policies and procedures to address, in the short term, its long-standing material weakness related to intradepartmental eliminations. In May 2019, DOD issued a department-wide policy memorandum that established procedures for reconciling intradepartmental differences. However, DOD has not taken action to ensure that the policy is fully implemented across the department. We found that DFAS and selected components we reviewed have not consistently updated their internal guidance to align with some of the requirements outlined in the department-wide policy memorandum. Additionally, selected components have not consistently implemented these requirements, such as routinely performing reconciliations of intradepartmental differences.

DOD Lacks an Overall Short-Term Strategy to Address Its Intradepartmental Eliminations Material Weakness

DOD has not yet developed an overall short-term department-wide strategy to correct its intradepartmental eliminations control deficiency prior to the full implementation of G-Invoicing. As we previously reported, developing and implementing a DOD department-wide strategy at the consolidated level requires DOD to identify the underlying causes and risks associated with control deficiencies and to prioritize efforts to address them.³² This involves clearly defining what is to be done, who is to do it, how it will be done, and the time frames for achievements. Without a clear strategy to address the material weakness across all DOD components in the short term, there is a risk that DOD's efforts to reduce intradepartmental differences will be unsuccessful, which in turn will hinder its ability to produce reliable and auditable consolidated financial statements.

The intradepartmental eliminations weakness is one of DOD's 25 material weaknesses identified in fiscal year 2019. In efforts to address this material weakness, DOD officials stated that in May 2019, the OUSD (Comptroller) issued *Financial Management Requirements for Trading*

³²GAO, *Department of Defense: Actions Needed to Reduce Accounting Adjustments*, [GAO-20-96](#) (Washington, D.C.: Jan. 10, 2020), 30.

Partner Eliminations, a policy memorandum documenting requirements for reconciling intradepartmental differences, and that DOD identified the implementation of G-Invoicing as its long-term solution. However, DOD officials stated that after performing risk management and effort prioritization activities, DOD has determined that other identified material weaknesses have higher priority. Therefore, DOD is not focusing its current department-wide efforts on further remediating the intradepartmental eliminations material weakness beyond the requirements included in the May 2019 policy memorandum and the implementation of G-Invoicing in the long term. Instead, DOD is currently relying on actions taken by the components themselves to address component-level intradepartmental eliminations issues while DOD addresses its other financial management priorities.

We found that most selected components have been proactive in identifying and addressing issues that cause intradepartmental differences in their individual components. For example, DISA implemented a process improvement initiative to strengthen and standardize its intradepartmental accounting, reconciliation, and reporting processes in part by identifying the causes for intradepartmental differences and establishing action plans to resolve the identified issues. As a result of this initiative, DISA has reduced the need to prepare unsupported top-side adjustments for unreconciled differences by approximately 90 percent over the past decade. While components' corrective actions may address some of the issues for intradepartmental differences, these corrective actions only apply at the individual component level and not department-wide.

Although DOD has begun implementing G-Invoicing's GT&C module, full implementation of G-Invoicing is still several years away. As previously mentioned, successful implementation of G-Invoicing may be limited by system design attributes that do not meet DOD's business needs, and the time needed to address these system limitations may even further delay DOD's full implementation. OMB Circular A-123, *Management's Responsibility for Enterprise Risk Management and Internal Control*, states that correcting control deficiencies is an integral part of management accountability and must be considered a priority by the agency. Additionally, OMB Circular A-123 requires agencies to perform cause analysis of identified deficiencies to ensure that subsequent strategies and plans address the causes of the problem and not just the symptoms. Therefore, without a short-term strategy that includes (1) identifying the leading causes of intradepartmental elimination issues, (2) establishing and monitoring corrective actions to address those causes,

and (3) measuring the effectiveness of such corrective actions department-wide, DOD may miss the opportunity to resolve some issues that cause intradepartmental differences prior to the full implementation of G-Invoicing. This may result in an increased risk that DOD will not achieve measurable progress in addressing its intradepartmental eliminations material weakness and that long-term efforts will not fully address the underlying causes.

DOD Issued a New Policy for Reconciling Buy/Sell Trading Partner Differences

As previously mentioned, DOD has made efforts to implement procedures for addressing intradepartmental differences when they occur. Specifically, in May 2019, the OUSD (Comptroller) issued a policy memorandum in response to an OIG's finding that certain procedures listed in DOD's department-wide policy regarding intradepartmental eliminations did not comply with government-wide guidance.³³ DOD subsequently updated its department-wide regulation, the *Financial Management Regulation* (FMR), to reflect the May 2019 policy's requirements. The May 2019 policy memorandum, which went into effect department-wide as of October 2019, contained several new requirements, such as provisions for trading partners to have specific documentation to support intradepartmental transactions and to use G-Invoicing's GT&C functionality for recording their agreements.

Additionally, the May 2019 policy memorandum rescinded some existing requirements such as the "seller-side rules" policy, which required the use of seller-side amounts as the basis for reporting both the buyer- and seller-side intradepartmental transaction balances. The justification for the "seller-side rules" policy was the presumption that seller-reported amounts are more accurate than corresponding buyer-reported amounts. The May 2019 policy memorandum also rescinded buyer-side waivers. These waivers were granted to components that were able to prove their buyer-side intradepartmental transaction data were more complete, accurate, and supported than the seller data. The waivers exempted these components from adjusting their balances to agree to seller-side amounts. The May 2019 policy memorandum changed these requirements by requiring trading partners to work together to reconcile

³³Specifically, DOD OIG found that DOD's "seller-side rules" policy did not comply with OMB Circular A-136, *Financial Reporting Requirements*, which requires federal entities to reconcile and resolve differences between intradepartmental balances and transactions.

and resolve intradepartmental differences throughout the reporting period as opposed to relying solely on seller-side or waived buyer-side intradepartmental balances. By issuing this new department-wide policy, DOD anticipated increased communication between trading partners in order to enable timely reconciliation of intradepartmental differences and to provide supportable balances for performing intradepartmental eliminations. However, DOD has not taken action to ensure that (1) internal DFAS and component policies reflect the department-wide policy or (2) the policy is fully implemented across DOD.

DFAS and Selected DOD Components Have Not Consistently Updated Their Policies and Procedures to Align with the Department-Wide Policy Memorandum

DFAS and selected DOD components we reviewed have not been consistent in issuing updates to align their internal guidance with the May 2019 policy memorandum on intradepartmental eliminations, such as rescinding “seller-side rules” and buyer-side waivers. Internal guidance links an agency’s objectives and policies to its day-to-day operations, providing a framework under which employees clearly understand their roles and responsibilities when carrying out agency objectives. Individual DFAS sites and selected DOD components have developed standard operating procedures (SOP) to facilitate the intradepartmental elimination process. These SOPs include topics such as the trading partner elimination process and performance of trading partner adjustments. However, our review of DFAS’s SOPs related to intradepartmental eliminations found that although the SOPs were updated since the issuance of the May 2019 policy memorandum, the updates did not incorporate several of the policy memorandum’s new requirements. For example:

- Twenty-two of the 23 SOPs were not updated to remove the “seller-side rules” requirement for recording intradepartmental transaction balances. These 22 SOPs still included language such as “seller-side information is presumed to be more accurate and shall be used as the basis for reporting both sides [buyer and seller] of any intragovernmental transaction.” Additionally, six SOPs incorrectly stated that based on current guidance from Treasury and the DOD FMR, “seller-side totals are the required trading partner amounts to be used.” However, both the current TFM and the DOD FMR require components to reconcile with their trading partners, and neither states

that seller-side totals are the required trading partner amounts to be used.

- Sixteen of 23 SOPs were not updated to remove the “waived entities” exception requirement for recording buyer-side amounts for intradepartmental transaction balances. For example, 10 SOPs still included supervisor review instructions that incorrectly required adherence to outdated DOD FMR requirements regarding waived entities. The updated FMR does not include any references to waived entities.

Some DFAS officials acknowledged that not including the May 2019 policy memorandum’s requirements was an oversight when they updated the SOPs. Based on our inquiry, DFAS officials indicated that they have either updated or will update the SOPs to align with the current policy. However, when we reviewed the SOPs that DFAS stated were updated since our inquiry, we found that most continued to include outdated guidance such as reliance on seller-side amounts for reporting both buyer- and seller-side intradepartmental balances.

Our review of eight selected DOD components’ SOPs identified similar issues as those identified for DFAS SOPs. We found the following:

- One selected component did not have component-level SOPs to implement the intradepartmental eliminations process.
- Five selected components have SOPs that support the intradepartmental eliminations process; however, these SOPs have not been updated to reflect the new requirements outlined in the May 2019 policy memorandum. For example, two components’ SOPs that have been updated since the issuance of the May 2019 policy memorandum still state that sellers must adjust their transaction amounts to match those of the components with buyer-side waivers.
- Two components have implemented SOPs that support the intradepartmental eliminations process, and these SOPs had been updated to reflect the new requirements of the May 2019 policy memorandum. For example, the Defense Logistics Agency’s SOP referenced OUSD (Comptroller)’s May 2019 policy memorandum, included most of the requirements of the memorandum, and contained no guidance that conflicted with the May 2019 policy memorandum.

In response to our inquiries regarding lack of component-level SOPs and outdated SOPs, most DOD component officials either stated that they rely

on existing policies or that they are in the process of updating their SOPs. For example, Army officials stated that the Army relies on DOD's FMR, the May 2019 policy memorandum, and DOD's quarterly *Financial Reporting Guidance* and does not have its own guidance for processing intradepartmental transactions. DISA officials stated that their SOPs will be reviewed and updated by the end of 2020.

Standards for Internal Control in the Federal Government requires management to implement control activities through policies.³⁴ To do this, management periodically reviews policies and procedures for continued relevance and effectiveness in achieving the entity's objectives or addressing related risks. If there is a significant change in an entity's process, management reviews this process in a timely manner after the change to determine that control activities are designed and implemented appropriately. Therefore, without updates to SOPs that reflect current DOD policy, there is an increased likelihood that DFAS and DOD components will continue to follow procedures that are not consistent with department-wide guidance. This may continue to result in the increased risk of incorrect reporting of intradepartmental balances in DOD's records and financial statements.

Selected DOD Components Have Not Fully Implemented the Updated Department-Wide Policy

Selected components have started to implement the May 2019 policy memorandum, but such implementation has not been consistent. Beginning in October 2019, DFAS and DOD components were required to implement the new requirements outlined in the memorandum. We found that the majority of the selected components we reviewed are not implementing the new requirements, as they are either (1) still following the "seller-side rules" for recording intradepartmental balances or (2) not reconciling trading partner differences throughout the reporting period.

Components are still following "seller-side rules." Five of the eight selected DOD components continue to rely on seller-side balances for determining the amount of their related buyer-side balances. These seller-side balances sometimes originate from legacy systems that use nonstandard data formats and do not maintain documentation at the

³⁴GAO, *Standards for Internal Control in the Federal Government*, [GAO-14-704G](#) (Washington, D.C.: September 2014).

transaction level.³⁵ DOD officials for these five components identified system limitations as the major contributor for still using seller-side amounts for recording intradepartmental balances. Some system limitations these officials identified included data integrity issues, such as manual entry errors, accounting systems unable to capture buyer-side data, or intradepartmental transaction information not consistently entered by staff into accounting systems. For example, one component official stated that although its system is capable of capturing buyer-side data, that data field is not mandatory in its accounting system. Therefore, users infrequently enter buyer-side data into its accounting system, forcing the component to rely on seller-side balances.

To address these system limitations, DOD is replacing its legacy accounting systems by either migrating to or modernizing existing enterprise resource planning (ERP) systems, such as the Defense Enterprise Accounting and Management System that the Air Force uses.³⁶ DOD is anticipating that with the implementation of the ERP systems, the need to use seller-side data for intradepartmental balances will decrease because the ERP systems are intended to capture necessary trading partner data elements, such as buyer and seller trading partner codes and document identification numbers at the transaction level. DOD officials stated that they expect the selected components to fully migrate to or modernize ERP systems by 2027 or earlier.

Components are not reconciling intradepartmental differences routinely. The May 2019 policy memorandum requires components to work with their trading partners to routinely reconcile transactions either weekly, monthly, or quarterly to resolve intradepartmental differences. We found that components varied in the frequency with which they performed trading partner reconciliation. For example, officials at two components explained that they do not perform any trading partner reconciliations for reasons such as a lack of buyer-side data in their accounting systems or timing limitations given DOD's quarterly financial reporting schedule. Officials at two other components stated that they perform reconciliations only at the end of the quarterly reporting period. The other remaining four

³⁵Legacy systems are computer systems that are outdated but are still essential for an organization.

³⁶ERP refers to a type of software that organizations use to manage day-to-day business activities, such as accounting, procurement, project management, risk management and compliance, and supply chain management. ERP modernization efforts at DOD components include enhancing existing ERP systems so all necessary trading partner data elements are recorded.

selected components routinely perform reconciliations with their trading partners throughout the reporting period.

Some component officials also stated that one of the challenges that arises when components delay reconciliations until the end of the quarter is the large volume of intradepartmental transaction differences that needs to be resolved within the short time frame available for reconciliations in the quarterly DOD financial reporting schedule.³⁷ DOD components have less than a week to reconcile and resolve all intradepartmental differences, prior to intradepartmental balances being finalized for preparation of DOD's consolidated financial statements. For example, one component official stated that because of the large volume of intradepartmental differences, they have to postpone resolving the differences until after the quarterly financial reporting period. When intradepartmental transaction differences are not reconciled, DOD components rely on the seller-side balances to record intradepartmental balances despite DOD policy. Officials from both the U.S. Army Corps of Engineers and DISA stated that their monthly reconciliations are key to their intradepartmental eliminations processes because the reconciliations allow the components to resolve differences prior to the brief quarter-end window in the financial reporting schedule.

The integrity of the data reported in financial statements for DOD components and at the DOD-consolidated level depends on timely and accurate reconciliation of intradepartmental activity and resulting account balances. When components have to rely on seller-side data, or trading partners delay reconciliations until the end of the reporting period, DFAS must record top-side journal voucher adjustments in DDRS at the end of the quarter for any differences to make accounts balance prior to performing intradepartmental eliminations. Most of these top-side adjustments are unsupported because DDRS forces buyer-side balances to match seller-side balances without supporting documentation for the amounts of the adjustments. According to the FMR, adjustments to the accounting records should be supported with sufficiently detailed written documentation to provide an audit trail to the source transaction that requires the adjustment. When top-side adjustments are recorded without

³⁷DFAS issues the *Financial Reporting Guidance* quarterly on behalf of OUSD (Comptroller) that includes a schedule for quarterly reporting. According to that schedule, DOD reporting entities, or DFAS on behalf of the reporting entity, upload seller-side data on the 9th business day of the month following the end of the quarter. Seller-side challenges are due the 10th day, and DFAS processes updates for those challenges on the 11th day.

adequate supporting documentation, DFAS has no assurance that it is using the most accurate accounting data and there is an increased risk of material misstatement in DOD financial statements.

Conclusions

Auditors have reported a long-standing material weakness related to DOD's intradepartmental eliminations. If unaddressed, the material weakness will continue to lead to unreliable information in DOD's core financial reporting system, and as a result, DOD management and Congress may not have reliable and accurate financial information to support their decision-making. To address this material weakness, DOD has identified the implementation of the G-Invoicing system as its long-term solution. However, selected DOD components' initial implementation of G-Invoicing has not been consistent or complete. Ensuring that components are implementing DOD-wide policies and procedures related to G-Invoicing, as well as updating applicable guidance, would enhance DOD's ability to meet its stated time frame for full implementation.

Additionally, until G-Invoicing is fully implemented, developing a clear department-wide strategy with short-term solutions to address DOD's long-standing intradepartmental eliminations material weakness would help provide reliable information for DOD's financial statements. While DOD issued a department-wide policy to resolve intradepartmental differences, DFAS and selected components have not consistently updated their policies and procedures to align with the department-wide policy or routinely reconciled intradepartmental differences as required. Ensuring that component-level and department-wide guidance is consistent and up-to-date, and increasing the frequency of trading partner reconciliations, would help DOD to address its material weakness in the short term. If DOD does not address these issues, there is an increased risk that its financial information will be misstated and DOD will continue to be unable to prepare reliable and auditable consolidated financial statements.

Recommendations for Executive Action

We are making the following five recommendations to DOD:

- The Under Secretary of Defense (Comptroller) should take actions to help ensure that all DOD components follow its policy requiring the

use of G-Invoicing's GT&C functionality to initiate and approve GT&C agreements. (Recommendation 1)

- The Under Secretary of Defense (Comptroller), in conjunction with the Under Secretary of Defense (Acquisition & Sustainment), should update all applicable guidance, such as DOD Instruction 4000.19, to reflect the use of G-Invoicing and its GT&C functionality for initiating and approving GT&C agreements. (Recommendation 2)
- The Under Secretary of Defense (Comptroller) should develop a strategy to identify short-term solutions that can be implemented in advance of the full implementation of G-Invoicing to address the intradepartmental eliminations material weakness. Such solutions should include documented procedures to (1) identify the causes for intradepartmental differences, (2) monitor the results of action plans prepared by components, and (3) measure whether implemented action plans are effective in addressing the causes for intradepartmental differences. (Recommendation 3)
- The Under Secretary of Defense (Comptroller), in conjunction with the Director of DFAS, should ensure that DFAS and DOD components update their SOPs to include the requirements of OUSD (Comptroller)'s May 2019 policy memorandum, *Financial Management Requirements for Trading Partner Eliminations*, such as the removal of "seller-side rules" and "waived entity" language. (Recommendation 4)
- The Under Secretary of Defense (Comptroller), in conjunction with the Director of DFAS, should
 - (1) update policies and procedures department-wide to require the performance of trading partner reconciliations at least monthly, where possible, to avoid large numbers of differences that need to be resolved at quarter end, and
 - (2) for DOD components that are unable to perform monthly reconciliations because of system limitations, evaluate alternative methods to capture the data needed to perform trading partner reconciliations, such as buyer and seller trading partner codes and document identification numbers. (Recommendation 5)

Agency Comments

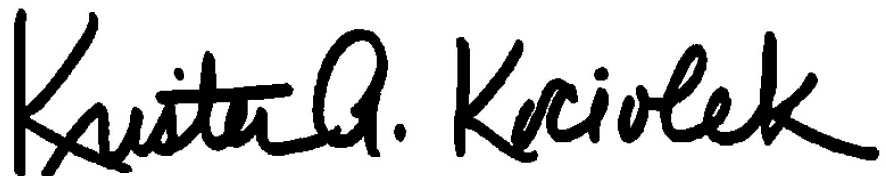
We provided a draft of this report to DOD for review and comment. In written comments, DOD concurred with all five of our recommendations

and cited actions to address them. DOD comments are reproduced in appendix II.

We are sending copies of this report to the appropriate congressional committees, the Secretary of Defense, the Under Secretary of Defense (Comptroller), the Director of the Defense Finance and Accounting Service, and other interested parties. In addition, the report is available at no charge on the GAO website at <https://www.gao.gov>.

If you or your staff have any questions about this report, please contact me at (202) 512-2989 or kociolekk@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff who make key contributions to this report are listed in appendix III.

Sincerely yours,

A handwritten signature in black ink that reads "Kristen A. Kociolek". The signature is written in a cursive, flowing style.

Kristen Kociolek
Director, Financial Management and Assurance

Appendix I: Objectives, Scope, and Methodology

This report examines the extent to which (1) Department of the Defense (DOD) and selected components have identified issues related to intradepartmental eliminations and taken steps to address them and (2) DOD has established and implemented policies and procedures related to eliminations.

To address our two objectives, we analyzed DOD’s intradepartmental eliminations summary data by category and quantity for the second quarter of fiscal year 2020.¹ Based on our review of the summary data, we identified three categories of eliminations that were relevant to intradepartmental eliminations—buy/sell transactions, fiduciary transactions, and transfer transactions (see table 2). The buy/sell transactions category comprised approximately 92 percent of the total volume of all intradepartmental eliminations for the selected period.² Therefore, for all objectives, we focused the scope of our review to the buy/sell transaction category.

Table 2: Intradepartmental Eliminations by Category and Quantity as of Second Quarter Fiscal Year 2020

Intradepartmental transaction category	Buy/sell	Fiduciary	Transfers	Total
Quantity of eliminations	6,702	70	534	7,306
Percentage of total	92	1	7	100

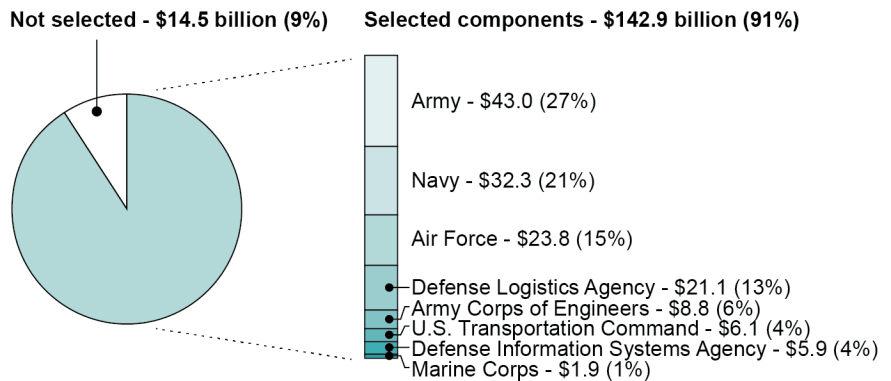
Source: GAO analysis of DOD information. | GAO-21-84

¹In May 2019, the Under Secretary of Defense issued a policy, *Financial Management Requirements for Trading Partner Eliminations* (FPM 19-03), which updated DOD policy on intradepartmental eliminations. This policy went into effect starting in fiscal year 2020. Therefore, we used the intradepartmental eliminations summary data provided by DOD for the first two quarters of fiscal year 2020 to select the intradepartmental transaction categories and select components to be reviewed. The summary data were generated from the Defense Departmental Reporting System—Audited Financial Statements module, one of two primary modules within the Defense Departmental Reporting System used in preparing the consolidated financial statements.

²The Treasury Financial Manual identifies five categories of intragovernmental transactions—buy/sell transactions, fiduciary transactions, transfers transactions, custodial and non-entity transactions, and general fund transactions. Of these five, DOD uses the buy/sell, fiduciary and transfers categories for its intradepartmental transactions.

Additionally, for all objectives, we limited our review to Tier 1 and selected Tier 2 DOD components as identified by DOD for fiscal year 2019.³ We reviewed all Tier 1 DOD components except for the Military Retirement Fund, which did not have any intradepartmental buy/sell transactions for the selected period. For Tier 2 components, using the summary data mentioned above, we selected the three components that had the largest buy/sell elimination dollar amounts—the Defense Logistics Agency, the Defense Information Systems Agency, and the U.S. Transportation Command. As shown in figure 5, the Tier 1 and Tier 2 components selected for review represent 91 percent of the total dollars of DOD intradepartmental buy/sell eliminations as of the second quarter of fiscal year 2020.

Figure 5: Fiscal Year 2020 Second Quarter Buy/Sell Intradepartmental Eliminations



Source: GAO analysis based on Department of Defense information. | GAO-21-84

³Tier 1 components are components that are required by the Office of Management and Budget to prepare annual audited financial statements. For fiscal year 2019, DOD identified eight Tier 1 components and one Fund—Department of the Army (Working Capital and General Fund), Department of the Air Force (Working Capital and General Fund), Department of the Navy (Working Capital and General Fund), U.S. Marine Corps (General Fund), U.S. Army Corps of Engineers, and the Military Retirement Fund. For this report, we defined components as including the related funds (e.g., Department of the Army as one component consisting of a working capital fund and a general fund). Therefore, for the purpose of this report, we reviewed five Tier 1 components—Department of the Army, Department of the Navy, Department of the Air Force, U.S. Marine Corps, and the U.S. Army Corps of Engineers. Tier 2 components (as identified by DOD) for fiscal year 2019 consisted of 15 components that DOD also required to undergo and issue annual financial statement audits.

Data table for Figure 5: Fiscal Year 2020 Second Quarter Buy/Sell Intradepartmental Eliminations (Dollars in billions)

	Amount	Percentage
Not selected	\$14.5	9%
Selected components	\$142.9	91%

Breakdown of Selected Components

Department	Amount	Percentage
Army	\$43.0	27%
Navy	\$32.3	21%
Air Force	23.8	15%
Defense Logistics Agency	\$21.1	13%
Army Corps of Engineers	\$8.8	6%
U.S. Transportation Command	\$6.1	4%
Defense Information Systems Agency	\$5.9	4%
Marine Corps	\$1.9	1%

Source: GAO analysis based on Department of Defense information. | GAO-21-84

To address our first objective, we reviewed (1) prior reports issued by GAO, DOD’s Office of Inspector General, independent public accounting firms, and DOD service auditors for fiscal years 2015 through 2019 and (2) auditors’ notices of finding and recommendation with corresponding DOD corrective actions for fiscal year 2019 to gain an understanding of the nature of the issues related to intradepartmental eliminations that auditors identified. Additionally, we conducted interviews with the Office of the Under Secretary of Defense (OUSD) (Comptroller), Defense Finance and Accounting Service (DFAS), and selected DOD component officials to evaluate the

- procedures implemented to identify issues associated with intradepartmental eliminations,
- steps taken and initiatives planned to resolve identified issues, and
- monitoring activities implemented to determine if the actions taken to resolve the identified issues are effective.

We determined that the monitoring component of internal control was significant to this objective, specifically the underlying principle that

management should establish and operate monitoring activities to monitor the internal control system and evaluate the results.⁴

To address our second objective, we reviewed applicable government-wide guidance, DOD's department-wide guidance, and DFAS's and selected DOD components' guidance for recording and reconciling intradepartmental transactions. Next, we compared the requirements for recording intradepartmental transactions and reconciling intradepartmental differences in DOD's department-wide guidance against the requirements in the Office of Management and Budget's (OMB) Circular A-136, *Financial Reporting Requirements*, and the Department of the Treasury's *Treasury Financial Manual*.⁵ We then reviewed the requirements in DFAS's and selected components' guidance for recording and reconciling intradepartmental transactions to determine the extent to which these aligned with established DOD department-wide guidance.⁶

We followed up with DOD officials for any differences identified during our comparisons of DOD department-wide guidance and DFAS and selected component guidance. To determine if DFAS and selected DOD components have implemented the requirements listed in DOD's department-wide guidance for recording and reconciling intradepartmental transactions, we interviewed DFAS and selected DOD component officials. We determined that the control activities component of internal control was significant to this objective, specifically the underlying principle that management should implement control activities through policies.⁷

We conducted this performance audit from March 2020 to January 2021 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain

⁴GAO, *Standard for Internal Control in the Federal Government*, [GAO-14-704G](#) (Washington, D.C.: September 2014).

⁵Office of Management and Budget, *Financial Reporting Requirements*, OMB Circular No. A-136 (Washington, D.C.: revised June 28, 2019). While OMB issued an updated version of Circular A-136 in August 2020, we used the June 2019 version because it was the version in effect during the period covered by our audit.

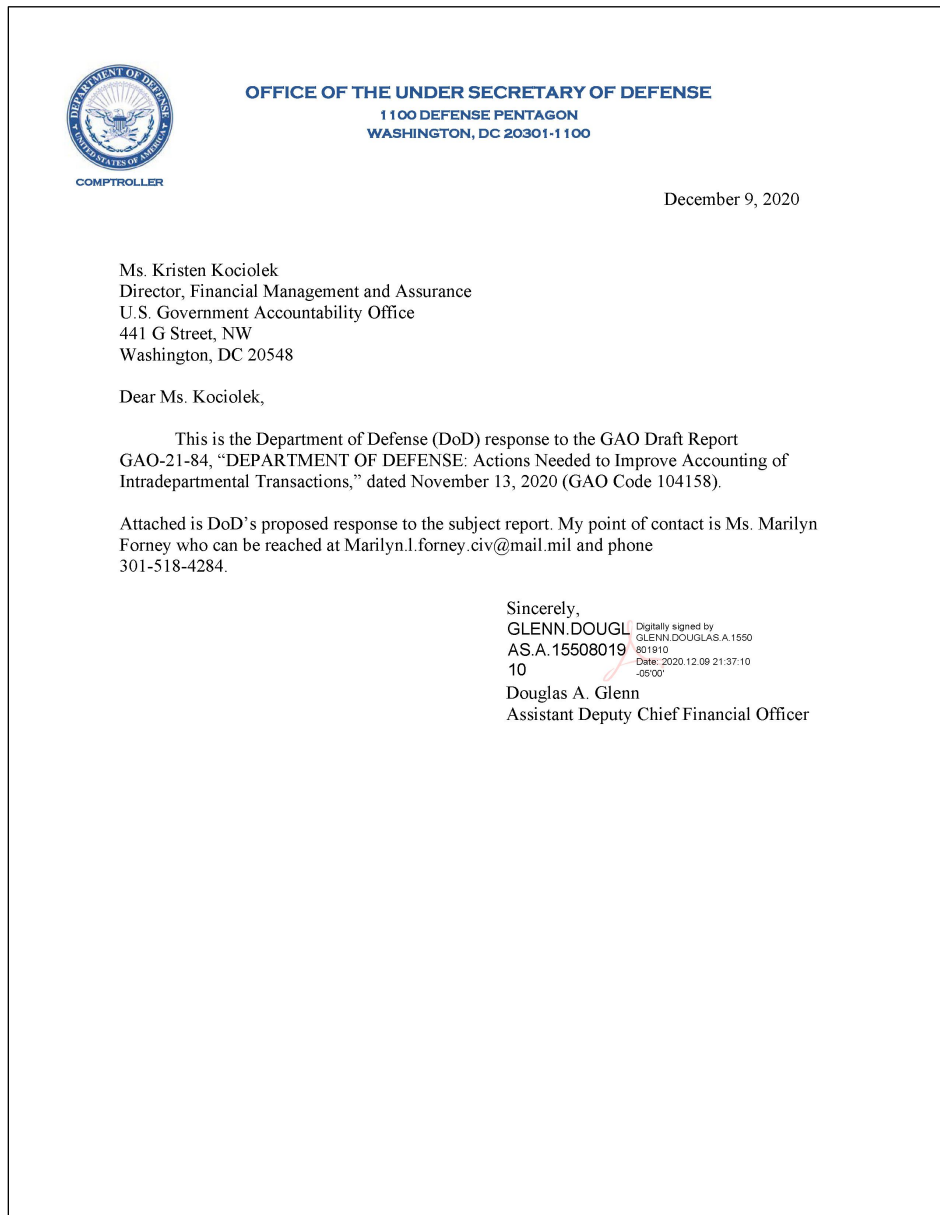
⁶DOD Financial Management Regulation, Volume 6B, Chapter 13 *Adjustments, Eliminations, and other Special Intragovernmental Reconciliation Requirements* (October 2019).

⁷[GAO-14-704G](#).

**Appendix I: Objectives, Scope, and
Methodology**

sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Appendix II: Comments from the Department of Defense



**GAO DRAFT REPORT DATED NOVEMBER 13, 2020
GAO-21-84 (GAO CODE 104158)**

**“DEPARTMENT OF DEFENSE: ACTIONS NEEDED TO IMPROVE ACCOUNTING
OF INTRADEPARTMENTAL TRANSACTIONS”**

**DEPARTMENT OF DEFENSE COMMENTS
TO THE GAO RECOMMENDATION**

RECOMMENDATION 1: The GAO recommends that the Under Secretary of Defense (Comptroller) should take actions to help ensure that all DOD components follow its policy requiring the use of G-Invoicing’s GT&C functionality to initiate and approve GT&C agreements to meet the October 2022 timeframe.

DoD RESPONSE: Concur. The Department will increase the engagement of senior leadership for directing Component implementation of policy concerning use of the G-Invoicing Tool to initiate and approve GT&C agreements.

RECOMMENDATION 2: The GAO recommends that the Under Secretary of Defense (Comptroller), in conjunction with the Under Secretary of Defense (Acquisition & Sustainment), should update all applicable guidance such as DOD Instruction 4000.19 to reflect the use of G-Invoicing and its GT&C functionality for initiating and approving GT&C agreements.

DoD RESPONSE: Concur. The Office of the Under Secretary of Defense (Comptroller) is in collaboration with policy staff in the Office of the Under Secretary of Defense (Acquisition and Sustainment) to update DoDI 4000.19, Support Agreements, to establish formal inter- and intra-agency support policy providing for DoD Components use of the G-Invoicing tool and its GT&C functionality for initiating and approving GT&C agreements.

RECOMMENDATION 3: The GAO recommends that the Under Secretary of Defense (Comptroller) should develop a strategy to identify short-term solutions that can be implemented in advance of the full implementation of G-Invoicing to address the intradepartmental eliminations material weakness. Such solutions should include documented procedures to (1) identify the causes for intradepartmental differences, (2) monitor the results of action plans prepared by components, and (3) measure whether implemented action plans are effective in addressing the causes for intradepartmental differences.

DoD RESPONSE: Concur. The Department will establish a working group to develop common procedures and processes and work with the Components to require reporting on updates of status on implementing interim procedures for eliminating the intradepartmental eliminations materiel weakness.

RECOMMENDATION 4: The GAO recommends that the Under Secretary of Defense (Comptroller), in conjunction with the Director of DFAS, should ensure that DFAS and DOD components update their standard operating procedures to include the requirements of OUSD's May 2019 policy memorandum, "Financial management Requirements for trading Partner Eliminations," such as the removal of "seller-side rules" and "waived entity" language.

DoD RESPONSE: Concur. The Department will develop procedures for validating that Components implement in their standard operating procedures and policy requirements established in the May 2019 memorandum, "Financial Management Requirements for Trading Partner Eliminations," such as the removal of "seller-side rules" and "waived entity" language.

RECOMMENDATION 5: The GAO recommends that the Under Secretary of Defense (Comptroller), in conjunction with the Director of DFAS, should:

- (1) Update policies and procedures department-wide to require the performance of trading partner reconciliations on at least a monthly basis, where possible, to avoid large numbers of differences that need to be resolved at quarter end, and
- (2) For DOD components that are unable to perform monthly reconciliation due to system limitations, evaluate alternative methods to capture the data needed to perform trading partner reconciliations, such as buyer and seller trading partner codes and document identification numbers

DoD RESPONSE: Concur. The Department will:

- (1) Update the FMR to require monthly trading partner's reconciliations where possible.
- (2) The Department will assist in the development of alternative reconciliation methods for Components that have system limitations.

Text of Appendix II: Comments from the Department of Defense

Page 1

December 9, 2020

Ms. Kristen Kociolek

Director, Financial Management and Assurance

U.S. Government Accountability Office

441 G Street, NW

Washington, DC 20548

Dear Ms. Kociolek,

This is the Department of Defense (DoD) response to the GAO Draft Report

GAO-21-84, "DEPARTMENT OF DEFENSE: Actions Needed to Improve Accounting of Intradepartmental Transactions," dated November 13, 2020 (GAO Code 104158).

Attached is DoD's proposed response to the subject report. My point of contact is Ms. Marilyn Forney who can be reached at Marilyn.I.forney.civ@mail.mil and phone

301-518-4284.

Sincerely,

Douglas A. Glenn

Assistant Deputy Chief Financial Officer

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GAO DRAFT REPORT DATED NOVEMBER 13, 2020 GAO-21-84 (GAO
CODE 104158) "DEPARTMENT OF DEFENSE: ACTIONS NEEDED TO
IMPROVE ACCOUNTING OF INTRADEPARTMENTAL TRANSACTIONS"

DEPARTMENT OF DEFENSE COMMENTS TO THE GAO
RECOMMENDATION

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Appendix III: GAO Contact and Staff Acknowledgments

GAO Contact

Kristen Kociolek, (202) 512-2989 or kociolek@gao.gov

Staff Acknowledgments

In addition to the contact named above, Kimberly McGatlin (Assistant Director), Rathi Bose, Benjamin Durfee, Patrick Frey, Juan Garay, Matthew Gardner, Jason Kelly, Dacia Stewart, and Anne Thomas made key contributions to this report.

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